

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

PROPOSED ADJUSTMENT OF THE )  
WHOLESALE WATER SERVICE RATE OF THE ) CASE NO. 2006-00067  
CITY OF LAWRENCEBURG, KENTUCKY )

ORDER

The city of Lawrenceburg, Kentucky (“Lawrenceburg”) has proposed to adjust its existing rate for wholesale water service to South Anderson Water District (“South Anderson District”) effective for service on and after February 27, 2006. Lawrenceburg’s proposed rate is set forth in a rate schedule and an amendment to its present Water Purchase Contract with South Anderson District. Both documents provide, *inter alia*, that Lawrenceburg’s rate shall be adjusted annually “in accord with the increase in the Consumer Price Index as provided by the Kentucky Governor’s Office for Local Development.”

On February 24, 2006, the Commission initiated an investigation into the reasonableness of the proposed rate revision. As the principal focus of the Commission’s investigation was on the proposed automatic adjustment factor and as Lawrenceburg and South Anderson District had agreed to the proposed rates, the Commission suspended the proposed rates for one day and then permitted the rates to become effective subject to refund. In its Order initiating this investigation, the Commission propounded several interrogatories to Lawrenceburg regarding the proposed adjustment and the automatic adjustment factor. Lawrenceburg has responded to these interrogatories.

Having carefully reviewed Lawrenceburg's responses and considered the contract, the Commission finds that the agreed rate schedule should be approved. The purpose of the Commission's jurisdiction over a municipal utility's wholesale transactions with a public utility is to ensure that any public utility "consumer/customer that has contracted and become dependent for its supply of water from a city utility is not subject to either excessive rates or inadequate service." Simpson County Water District v. City of Franklin, Ky., 872 S.W.2d 460, 465 (1994).

In the case at bar, this purpose has been served. The municipal utility and public utility have discussed these proposed rates and have reached an accommodation. As the proposed rates, with the exception noted below, on their face appear neither unreasonable nor unconscionable, the Commission sees no need to conduct further proceedings in this matter regarding the agreed rate.

The contract between Lawrenceburg and South Anderson District provides that the present rates be adjusted on May 31 of each year to reflect any increases in the Consumer Price Index ("CPI") that the Department of Local Government computes pursuant to KRS 83A.075(1). Lawrenceburg contends that this adjustment mechanism is an accurate and impartial measure of changes in the cost of providing wholesale water service. It states that use of this adjustment mechanism benefits both utilities by avoiding the need for performing expensive cost-of-service studies and "the accompanying cost and uncertainty of having the results of the studies considered by the Commission.

KRS 83A.075(1) provides:

In order to equate the compensation of mayors and members of city legislative bodies with the purchasing power of the dollar, the Department for Local Government shall

compute by the second Friday in February of every year the annual increase or decrease in the consumer price index of the preceding year by using 1949 as the base year in accordance with Section 246 of the Constitution of Kentucky which provides that the mayor in cities of the first class shall be paid at a rate no greater than twelve thousand dollars (\$12,000) per annum and mayors in cities other than the first class and legislative body members shall be paid at a rate no greater than seven thousand two hundred dollars (\$7,200) per annum.

This statute implements “the rubber dollar” theory that the Kentucky courts announced in Matthews v. Allen, 360 S.W.2d 135 (Ky. 1962). Under this theory, the maximum compensation levels for state and local governmental constitutional officers contained in Section 246 of the Kentucky Constitution must be adjusted annually in accordance with the current purchasing power of the dollar. These adjustments are generally based upon the CPI that the U.S. Bureau of Labor Statistics publishes.

While the Commission shares the parties’ desire for a cost-effective and accurate adjustment mechanism to reduce the need for costly or time consuming rate proceedings, we find no evidence in the record to suggest that the proposed adjustment mechanism is such a mechanism. To the contrary, it suffers from two major defects that limit its reliability and accuracy.

First, the proposed mechanism, which is based upon the CPI, is based upon too large and diverse a group of goods and services. The CPI is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.<sup>1</sup> This basket contains 8 major categories of goods and services: food and beverages; housing; apparel; transportation; medical care;

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<sup>1</sup> See generally <http://www.bls.gov/cpi/cpiovrw.htm#item2> (last visited Nov. 16, 2006).

recreation; education and communication; and other goods and services. Several of these categories are unrelated to the provision of water service. Their presence in the basket limits the CPI's accuracy as an adjustment mechanism. For example, increases in the cost of food and beverages, apparel and education would produce a positive increase in the CPI but have no effect on the cost of goods and services that are used to provide water service. An automatic adjustment mechanism must provide an accurate measurement of changes in the cost of providing water service. It therefore should be based principally on those goods and services that are reasonably likely to be used to provide water service.

Second, a proper automatic adjustment mechanism should reflect all changes in the cost of the inputs that are required to provide water service. The proposed mechanism will not reflect any reductions in the cost of service, only increases. Lawrenceburg argues that this lack of symmetry is necessary to protect the municipal utility in meeting its bond obligations. It further justifies the lack of symmetry by noting that the historical likelihood of negative CPI growth is remote. The Commission is of the opinion that this failure to provide for reductions in cost renders the proposed mechanism less likely to accurately reflect the cost of water and more likely to promote incorrect or improper pricing of water service.

The Commission finds that, given the proposed adjustment mechanism's defects, Section C.5 of the Water Purchase Contract between Lawrenceburg and South Anderson District, as amended by the "Amendment to Water Purchase Contract," should be stricken and given no legal effect.<sup>2</sup>

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<sup>2</sup> Our decision is limited only to the facts of this proceeding and should not be construed as finding that all pricing indexes are unreasonable per se.

IT IS THEREFORE ORDERED that:

1. The rates set forth in Appendix A are approved for wholesale water service that Lawrenceburg renders to South Anderson District on and after February 28, 2006.
2. Section C.5 of the Water Purchase Contract between Lawrenceburg and South Anderson District, as amended by the "Amendment to Water Purchase Contract," is stricken and shall have no legal effect.
3. Within 20 days of the date of this Order, Lawrenceburg shall file with the Commission revised tariff sheets that reflect the rates approved herein.

Done at Frankfort, Kentucky, this 21<sup>st</sup> day of November, 2006.

By the Commission

ATTEST:



Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2006-00067 DATED November 21, 2006

The following rates and charges are prescribed for the city of Lawrenceburg for wholesale water service to be provided to South Anderson Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

First 8,000,000 Gallons	\$17,200 (Minimum bill)
All Usage over 8,000,000 Gallons	\$2.00 per 1,000 gallons